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Dairy and Products

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Report Highlights:
EU milk production increased by 1% in 2005 and is forecast to increase slightly further in 2006 following a production quota increase. The extra milk supply was mainly used for the increase in cheese production. The increase in cheese production was driven by demand for domestic consumption and despite the decrease in exports. This is forecast to be the case for 2006 too. EU butter production was stable in 2005 and is forecast to decrease in 2006. Butter exports decreased in 2005 and are forecast to decrease even more in 2006. As a result, EU 2006 butter ending stocks are not expected to decrease compared to 2005. WMP production decreased in 2005 because of decreasing export opportunities and this is anticipated to continue in 2006. NFDM production increased in 2005 because of the decrease in casein production, but is forecast to decrease again in 2006. NFDM exports decreased in 2005 and will again in 2006, as stocks were depleted.

Includes PSD Changes: Yes
Includes Trade Matrix: No
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Executive Summary

EU milk production in 2005 increased in anticipation of a production quota increase and because of speculation by producers. A further slight increase in milk production is forecast for 2006. Most of this production increase went to the processing of cheese and cheese production is forecast to increase still further in 2006. This results from increased domestic demand, while cheese exports are under pressure. EU butter production was stable in 2005 and is even forecast to decrease in 2006. However, decreased export, as a result of lower export subsidies and increased competition are forecast to lead to a halt in the decrease of EU butter stocks, which was one of the major goals of recent EU dairy reforms. Production of Non-Fat Dry Milk (NFDM) increased in 2005 because production of casein decreased with the decrease in aid for casein production. Despite decreasing exports, EU NFDM stocks were depleted because of strong domestic demand. NFDM production is forecast to decrease again in 2006. Whole Milk Powder (WMP) production decreased in 2005 because of decreasing export opportunities. The same trend is expected to continue for WMP in 2006.

Milk production and consumption

Country:	**EU-25**					
Commodity:	**Dairy, Milk** (1000 Head / 1000 MT)					
	2004		**2005**		**2006**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2004**		**01/2005**		**01/2006**	
Cows In Milk	23,963	23,963	23,398	23,533	23,050	22,677
Cows Milk Deliveries to Dairies	130,812	130,620	131,750	132,027	132,250	132,300
Other Milk Production	4,389	4,627	4,400	4,770	4,410	4,760
Total Milk Production	135,201	135,247	136,150	136,797	136,660	137,060
Extra EU25 Imports	2	2	2	9	2	10
TOTAL SUPPLY	**135,203**	**135,249**	**136,152**	**136,806**	**136,662**	**137,070**
Extra EU25 Exports	170	175	150	150	150	150
Fluid Use Dom. Consum.	34,306	34,234	33,702	34,027	33,550	34,100
Factory Use Consum.	100,727	100,840	102,300	102,629	102,962	102,820
Feed Use Dom. Consum.	0	0	0	0	0	0
Total Dom. Consumption	135,033	135,074	136,002	136,656	136,512	136,920
TOTAL DISTRIBUTION	**135,203**	**135,249**	**136,152**	**136,806**	**136,662**	**137,070**

Sources: EU FAS offices, Eurostat and Global Trade Atlas

A final update on **2004** milk production in the EU revealed a downward revision in German cow milk production. Milk production from sheep and goat in Spain was revised higher. EU fluid milk consumption was slightly lower and factory use slightly higher than previously reported.

The EU **2005** dairy cow herd shows a decrease of two percent compared to 2004. However, the number was increased compared to previous reports, because of a revision of Polish cow numbers. This also resulted in a higher cow milk production, while milk production from other animals continues to expand. Producers in many MS already increased milk production in anticipation of the upcoming increases in milk production quota. In Germany, speculation by some milk producers that they would benefit from less competitive farmers underutilizing their quota, led to a surplus of the German milk production of 1.4 percent or 403,000 MT above quota. Austria, the Czech Republic and Poland also produced over quota, while France and the United Kingdom failed to use the full milk production quota. Intra-EU milk exports from the NMS to mainly Germany increased compared to 2004, despite a decreasing difference in milk prices. The additional milk supply was directed to the processing industry, while fluid milk consumption continued its long-term decrease, albeit at a slower pace than previously anticipated.

Three consecutive 0.5 percent increases in milk production quota in the EU-15, starting in **2006**, were agreed in the 2003 CAP Reform. The 0.5 percent quota increase only applies to 11 out of the EU 15 MS. Quotas for Greece, Spain, Italy and Ireland will not increase. However, milk production is forecast to increase only 0.2 percent, most of which in the NMS, less in the EU-15. The reason for this is that producers in several MS already increased production in 2005, while in other MS, in France particularly, governments are withholding the distribution of the extra quota for fear of market oversupply and, hence, decreases in milk prices to producers. In the United Kingdom, low milk prices may already have led to a structural underfill of milk production quota. A change in the German quota administration system will reduce the possibility to balance under- and overutilization of quotas, thereby limiting the incentive for competitive farmers to exceed their quotas. In the NMS, the increase mostly still originates from the redirection of on farm sales to deliveries to the industry. Again, the additional milk supply is expected to go into processing.

Cheese

Country:	**EU-25**					
Commodity:	**Dairy, Cheese** (1000 MT)					
	2004		**2005**		**2006**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2004**		**01/2005**		**01/2006**	
Beginning Stocks	0	0	0	0	0	0
Production	6,430	6,371	6,515	6,500	6,580	6,580
Extra EU25 Imports	106	106	100	95	100	90
TOTAL SUPPLY	**6,536**	**6,477**	**6,615**	**6,595**	**6,680**	**6,670**
Extra EU25 Exports	515	516	500	490	500	480
Domestic Consumption	6,021	5,961	6,115	6,105	6,180	6,190
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	6,021	5,961	6,115	6,105	6,180	6,190
Ending Stocks	0	0	0	0	0	0
TOTAL DISTRIBUTION	**6,536**	**6,477**	**6,615**	**6,595**	**6,680**	**6,670**

Sources: EU FAS offices, Eurostat and Global Trade Atlas

The **2004** cheese production was revised in several MS, resulting in an overall decrease and leading to a decrease in domestic consumption. Updated trade figures hardly changed.

Cheese production in **2005** increased by two percent compared to 2004. The reason is that production of cheese is the most profitable use for milk; the more so because of the decrease in guaranteed prices for butter and non-fat dry milk (NFDM). The replacement of NFDM in feed by dried whey also adds to the profitability of cheese production. Cheese production was down in the Netherlands as the result of a fire in a cheese plant. However, that was more than compensated by an increase in UK production to record levels, along with increases in Germany, Italy, Denmark and France. Italy is increasing its production of long maturing cheese brands. EU imports of cheese have decreased, while cheese exports also suffered from strong competition. Danish exports to the Middle East suffered from the cartoon boycott, but exports from the Benelux, France and Germany decreased also. Italy, in contrast, registered increased exports, primarily to the U.S. Domestic consumption of cheese in the EU continued to increase, with the largest increases in Germany, the UK and France. In France, increasing popularity of cheese from goat more than offset the waning consumption of the classical camembert and brie. Avian Influenza doesn't seem to have benefited EU cheese consumption as cheese is a potential substitute for processed pork and sausages, but not for poultry.

In **2006**, cheese production and consumption are forecast to continue to increase. Production in the Benelux is expected to recover, while further increasing consumption of cheese in food processing as well as of branded cheese in households is forecast to drive cheese production in other MS as well. Increased cheese production in the NMS is forecast to provide an increasing part of the cheese to the food processing industry in the EU-15. Cheese exports are forecast to further decrease because of international competition and domestic consumption.

Butter

Country:	**EU-25**					
Commodity:	**Dairy, Butter** (1000 MT)					
	2004		**2005**		**2006**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2004**		**01/2005**		**01/2006**	
Beginning Stocks	276	276	232	232	170	184
Production	2,154	2,154	2,150	2,155	2,145	2,130
Extra EU25 Imports	90	93	75	85	75	85
TOTAL SUPPLY	**2,520**	**2,523**	**2,457**	**2,472**	**2,390**	**2,399**
Extra EU25 Exports	352	354	360	340	360	280
Domestic Consumption	1,936	1,937	1,927	1,948	1,915	1,939
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	1,936	1,937	1,927	1,948	1,915	1,939
Ending Stocks	232	232	170	184	115	180
TOTAL DISTRIBUTION	**2,520**	**2,523**	**2,457**	**2,472**	**2,390**	**2,399**

Sources: EU FAS offices, Eurostat and Global Trade Atlas

EU butter production in **2005** remained stable. A decrease in butter production in the Benelux, as a result of a decrease in butteroil production, was offset by increases in butter production in Germany, Spain and the United Kingdom. EU butter imports, mostly in-quota for the UK market, were higher while butter exports were significantly lower than forecast in the past. The fall in exports was the result of deteriorating export markets in the second half of the year. Butter export to Russia faced stronger competition from Ukraine. As an exception, the UK was able to increase its butter exports to Mexico and the Gulf area in the Middle East, while exports from the Benelux to Morocco and destinations in Asia also increased. In addition, French exports of butteroil increased significantly. As a result, EU butter ending stocks were higher than previously anticipated. Domestic consumption remained fairly stable.

Butter production in **2006** is forecast to further decrease as benefits from butter processing further decrease from another cut in the intervention price for butter. However, butter production tends to remain stronger than one would expect taking into account the small increase in milk deliveries and higher increase in cheese production. This is a result of the consumer trend towards low fat cheeses and fresh products such as yogurts and fresh cheeses, which binds less milk fat than what would normally be expected. EU butter, and in particular butter oil exports, are forecast to further decrease. At the moment, Benelux butter oil exports experience strong competition from Oceania. Butter oil exports to Asian markets continue to exist mainly because of favorable freight costs. Danish butter exports to the Middle East suffered from the cartoon boycott. Despite consecutive cuts in the butter intervention price, EU butter prices remain uncompetitive on the world market. Bad export markets and the next upcoming intervention price cut have led to 21 thousand MT of intervention sales of butter into the 50 thousand MT butter intervention quota for 2006 in the first six weeks after opening of intervention. Speculation is already mounting whether the EC will have to open further intervention tenders for butter at reduced prices, after the 50 thousand MT intervention quota is filled. Domestic butter consumption is expected to continue to decline, mainly for health concerns. As a result, the expectation is that the decrease in EU butter stocks, as targeted by the reforms of the EU dairy regime in Agenda 2000 and the 2003 CAP Reform, may come to a halt.

Non-Fat Dry Milk

Country:	**EU-25**					
Commodity:	**Non Fat Dried Milk** (1000 MT)					
	2004		**2005**		**2006**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2004**		**01/2005**		**01/2006**	
Beginning Stocks	218	218	77	77	5	8
Production	1,066	1,066	1,035	1,094	1,035	1,060
Extra EU25 Imports	25	26	20	7	20	15
TOTAL SUPPLY	**1,309**	**1,310**	**1,132**	**1,178**	**1,060**	**1,083**
Extra EU25 Exports	282	283	225	197	200	185
Domestic Consumption	950	950	902	973	860	898
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	950	950	902	973	860	898
Ending Stocks	77	77	5	8	0	0
TOTAL DISTRIBUTION	**1,309**	**1,310**	**1,132**	**1,178**	**1,060**	**1,083**

Sources: EU FAS offices, Eurostat and Global Trade Atlas

EU production of NFDM increased in **2005** compared to 2004, contrarily to previously anticipated. Production increased in France, Germany, Ireland and the Benelux. Reasons for the increase in production were larger milk supplies, tight domestic market supplies as intervention stocks ran empty, consecutive decreases in aid for casein production and good export opportunities. On the contrary, UK NFDM output in 2005 was at its lowest level for a decade, and the decline in NFDM throughput was reported as disastrous for processing plants. EU NFDM imports decreased because of high world prices but also because imports from the NMS became intra-EU trade upon accession in 2004. NFDM exports decreased sharply towards the end of 2005 because the EC gradually reduced levels of export refunds as stocks dried up. Competition from Oceania hampered EU exports to Asian markets and competition from the U.S. also increased towards the end of the year. Domestic consumption of NFDM was robust despite decreasing aid for incorporation of NFDM into feed compounds. Human consumption of NFDM increased in Spain and the UK, while the expansion in veal production increased use for feed in the Netherlands.

In **2006**, European NFDM production is forecast to decrease because cheese processing draws more milk and lower NFDM prices will decrease profitability. Productions in Germany and the UK are forecast to decrease to record lows. Production in Sweden will decrease drastically as a processing plant has converted to the processing of WMP. In contrast, NFDM production in Ireland is forecast to increase because of the low production level of casein. Imports are expected to partially recover. NFDM exports are forecast to further decrease for lack of supplies and low export subsidies. At the beginning of 2006, EU exporters were virtually incapable to export because of competition from the U.S. and Oceania. Domestic consumption, especially for feed, is forecast to decrease as it is expected that the substitution of poultry with veal, which resulted from the consumer scare for Avian Influenza in France and Italy, will end at some point in 2006. Nevertheless, no sales of NFDM for intervention are anticipated.

Whole Milk Powder

Country:	**EU-25**					
Commodity:	**Dairy, Whole Milk Powder** (1000 MT)					
	2004		**2005**		**2006**	
	Old	New	Old	New	Old	New
Calendar Year Begin	**01/2004**		**01/2005**		**01/2006**	
Beginning Stocks	0	0	0	0	0	0
Production	857	857	860	840	855	840
Extra EU25 Imports	3	3	2	2	2	2
TOTAL SUPPLY	**860**	**860**	**862**	**842**	**857**	**842**
Extra EU25 Exports	514	517	495	490	490	470
Domestic Consumption	346	343	367	352	367	372
Other Use, Losses	0	0	0	0	0	0
TOTAL Dom. Consumption	346	343	367	352	367	372
Ending Stocks	0	0	0	0	0	0
TOTAL DISTRIBUTION	**860**	**860**	**862**	**842**	**857**	**842**

Sources: EU FAS offices, Eurostat and Global Trade Atlas

EU production of Whole Milk Powder (WMP) in **2005** decreased as a result of decreasing export opportunities. WMP exports decreased because of decreases in EU export subsidies and increased competition, in particular from New Zealand. French exports to Algeria suffered from competition from Argentina, while WMP exports to the Middle East, especially Danish exports, also suffered from the cartoon boycott. Domestic consumption in food processing increased slightly.

Forecasts for EU WMP production in **2006** are stable. Exports are forecast to further decline because of strong competition on the world market and low world market prices. In April 2006, the EC increased export subsidies again to support EU exports. Nevertheless, export outlooks remain bleak and the forecast increase in domestic consumption will likely include some building of commercial stocks.

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